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Synopsis

Perspective—*Beyond Latin America: Expansion of LDC Financial Problems* [redacted] 25X1

Although Latin America's debt problems have been the focus of the international financial press, further questions are being raised regarding the status of developing countries outside the Western Hemisphere. The great concern now is to what extent the cutoff of new credit to Latin America will spread to Asia, Africa, and even Europe. [redacted] 25X1

Zaire: President Mobutu's Visit [redacted] 25X1

Zairian President Mobutu, who will visit Washington in early August, is likely to appeal for greater security and economic assistance, arguing has case by pointing to his military support for the beleaguered pro-Western regime in Chad and to recent Zairian economic and political reforms. [redacted] 25X1

Nigeria: The Economy Under Civilian Rule [redacted] 25X1

Heightened tensions associated with national elections scheduled for next month will severely test the survivability of the Shagari government and Nigeria's still untested democratic institutions. We anticipate that Lagos in the near term will increase pressure on the United States to help rescue Nigeria's flagging economy by interceding with the IMF, providing food assistance, and persuading US banks to agree to restructure Nigeria's increasingly burdensome debt. [redacted] 25X1

Iranian Natural Gas: An East-West Issue [redacted] 25X1

Iran's enormous natural gas reserves—exceeded only by the Soviet Union's—have been viewed as a potential source to supply to Western nations, particularly by countries in Western Europe. Iran's gas export potential, however, is limited by a number of economic, financial, and technical constraints. [redacted] 25X1

Eastern Europe: Future Demand for Soviet Natural Gas [redacted] 25X1

Although Eastern Europe is planning to buy more natural gas from the Soviet Union over the coming decade, it may well take less than the USSR would like to deliver. [redacted] 25X1

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Perspective

Beyond Latin America: Expansion of LDC Financial Problems [redacted] 25X1

Although Latin America's debt problems have been the focus of the international financial press, further questions are being raised regarding the status of developing countries outside of the Western Hemisphere. The serious problems of Brazil, Mexico, and Argentina have caused lenders—particularly international banks—to take a hard look at their overseas lending activities in general. Financial reporting and banking statistics indicate that lending has slowed sharply in first-half 1983 and that much of the new lending that did occur was for debt restructurings.

Most financial analysts note that the recent propensity of regional US and European banks to "cut and run" has made the situation worse. The great concern now is to what extent the cutoff of new credit to Latin America will spread to Asia, Africa, and even Europe. Although bankers often claim that LDCs are treated individually, the evidence over the past 12 months indicates that LDC risk is grouped regionally and in some instances globally.

We are now seeing increased interest in financial problems of areas other than Latin America. African countries that were considered good credit risks as late as last year are now experiencing tightening of new lending by banks. Morocco and the Ivory Coast are two major borrowers from private banks that may face debt rescheduling this year because of creditor reluctance to lend and depressed domestic economies. Nigeria, which recently reached agreement on a rescheduling of about $1.6 billion in short-term debt has also suffered as tightened lending coincided with weak oil prices.

Asia, long considered the best credit risk of any LDC region, also has had its image tarnished somewhat in recent months. The weakest link in the region is the Philippines, which has been hurt by the sluggish world economy. Although bankers remain generally confident about the Philippines, some believe that rougher times are ahead, and that some form of debt restructuring may be needed this year.

Although some bankers think a Philippine rescheduling could trigger an Asian financial crisis along the lines of the Latin American situation, we believe this to be unlikely because of the relatively stronger financial positions of the other Asian countries. In addition, several Asian LDCs have taken steps to reassess their borrowing strategies. [redacted] South Korea and 25X1

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Thailand have scaled down their projected borrowing needs, while Indonesia canceled numerous development projects and reduced domestic expenditures. Malaysia borrowed heavily from international banks last year at very favorable rates in order to satisfy most of this year's borrowing requirements.

Financial problems have not been limited to the developing world; several smaller West European countries have felt a squeeze during 1983. Portugal and Greece are both experiencing debt servicing problems and could face a debt restructuring later this year. Moreover, new bank lending to Eastern Europe has virtually dried up and prospects remain bleak for the near future.

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Briefs

Energy

Canada Sets New Natural Gas Export Price

On 6 July, Canadian Energy Minister Jean Chretien introduced a Volume Related Incentive Pricing program (VRIP) for natural gas exports in an effort to increase sales to the United States. Under the new policy, a discount price of $3.40 per thousand cubic feet will be offered for volumes of natural gas sold in excess of 50 percent of previously authorized exports or actual 1982 sales—whichever is less. The current export price, which Chretien lowered in April to $4.40 per thousand cubic feet from $4.94 per thousand cubic feet, will be maintained for volumes below the 50-percent level. This program probably will not substantially increase gas exports this year. For the first six months of 1983, Canadian exporters sold only 30 percent of authorized exports and are unlikely to reach the minimum levels required to qualify for the discounted rate. In fact, Ottawa expects to sell 5 to 10 percent less natural gas in 1983 than last year's 775 million cubic feet. Beginning 1 November, however, exporters will be able to calculate the incentive price on a monthly instead of the present annual basis, which should more quickly qualify exports for the incentive price. [redacted] 25X1

The VRIP was introduced, in part, to answer US complaints that Canadian natural gas prices were unrealistically high and the pricing policy too inflexible for current market conditions. Canadian natural gas provides only 4 percent of the total US gas supply, but constitutes a considerably higher percentage in some northwestern markets. Natural gas is Canada's second most important export and contributed $3.9 billion to the positive trade balance in 1982. [redacted] 25X1

Japanese Energy Procurement From United States

[redacted] Japan currently has little desire to purchase Alaskan oil and no interest in US liquefied natural gas. US coal, however, has a potential market in Japan. Officials at the Agency of Natural Resources and Energy say the United States misunderstood Japan's intentions on procurement during the recent energy talks in Tokyo. They doubt that future energy purchases will substantially reduce Japan's trade surplus with the United States. [redacted] 25X1 25X1

[redacted] 25X1 Tokyo has not ruled out future purchases of Alaskan oil if price and market conditions are right. At the same time, it judges that LNG piped from Alaska will be too expensive to compete with established sources of supply in Southeast Asia. [redacted] 25X1

Selected OECD Countries: Estimated Imports and Consumption of Crude Oil and Refined Products, 1982

Thousand b/d

	OECD	US	Japan	Canada	West European Total	West Germany	France	UK	Italy
OAPEC	9,011	898	2,691	87	5,155	787	1,007	362	1,077
Algeria	797	170	41	20	566	111	159	22	109
Bahrain	23	0	14	0	3	1	NEGL	0	1
Egypt	267	42	7	11	207	23	26	23	109
Iraq	482	3	62	0	417	16	30	21	114
Kuwait	339	5	124	NEGL	186	12	18	15	73
Libya	935	26	2	1	906	226	50	46	219
Qatar	276	7	139	0	129	8	41	5	28
Saudi Arabia	4,829	552	1,729	53	2,378	344	552	193	389
Syria	1	1	0	0	0	0	0	0	0
United Arab Emirates	1,062	92	573	2	363	46	131	37	35
OPEC [a]	12,827	2,146	3,538	191	6,698	991	1,241	459	1,397
Ecuador	44	42	0	0	2	0	0	0	1
Gabon	93	40	0	0	53	6	24	3	1
Indonesia	943	248	619	0	6	NEGL	1	1	2
Iran	1,111	35	216	8	842	45	74	51	258
Nigeria	1,054	514	0	4	536	133	133	35	65
Venezuela	862	412	33	103	314	44	28	30	103
Other Countries	5,309	2,924	920	172	2,743	1,209	710	435	544
Canada		428	NEGL		14	NEGL	0	3	1
Mexico	1,224	685	96	52	391	1	59	12	77
Others [b]	4,085 [c]	1,757	824	120	2,338 [d]	1,208	651	420	466
Total Imports	**18,427** [c]	**5,113**	**4,479**	**374**	**9,651** [d]	**2,224**	**1,977**	**917**	**2,051**
Total Consumption	**33,743**	**15,253**	**4,503**	**1,573**	**11,744**	**2,226**	**1,814**	**1,546**	**1,766**

[a] OAPEC members excluding Bahrain, Egypt, and Syria, plus those countries listed under the OPEC heading.
[b] Including unknown.
[c] Excluding intra-OECD trade.
[d] Excluding intra-European trade.

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OECD Oil Import Requirements

OECD oil imports averaged 18.4 million b/d last year—down from 20.6 million b/d in 1981. Despite the lower level of imports, OECD countries remained dependent on imports for 55 percent of total oil requirements. Japan and Western Europe relied on imports for nearly 100 percent and more than 80 percent of oil requirements, respectively, compared with less than 35 percent for the United States. [redacted] 25X1

OPEC countries remain the major source of OECD oil imports, supplying nearly 13 million b/d or 70 percent of the total import requirements. OPEC countries accounted for 70-80 percent of West European and Japanese imports compared with roughly 40 percent for the United States. Reliance on imported oil among major West European countries varied widely with France, Italy, and West Germany remaining almost totally dependent on imports. Domestic production in the United Kingdom exceeded requirements for the last two years although London continued to import some oil to meet specific refinery requirements. [redacted] 25X1

Impasse in Gas Negotiations Between Italy and the USSR

The acrimonious trade and energy talks in Moscow last week between Italian and Soviet representatives will further delay an agreement on Italian purchases of natural gas through the Siberian export pipeline. [redacted] 25X1 [redacted] Rome rejected Soviet demands for concessionary trade 25X1 credits. The Soviets did not agree to any specific measures to reduce Italy's $1.9 billion trade deficit for 1982—one of Rome's conditions for serious negotiations on additional purchases of Soviet gas. Soviet officials also refused to renegotiate the existing agreement in principle regarding future gas sales. They contended that it constitutes a final contract. [redacted] 25X1

An Italian decision on the politically sensitive gas contract will have to await the formation of a new government. Even so, Rome will still seek specific Soviet actions to redress the trade imbalance and will resist Moscow's demands for credit concessions. Italy also will want to renegotiate gas prices and may try to reduce its gas imports from the 6-8 billion cubic meters originally agreed on. The US Embassy says Italian energy officials may want to lower minimum import quantities to perhaps 4 billion cubic meters because of the drop in domestic demand. The Soviets' comments before the talks indicated that they ultimately will accede to Rome's major demands. The USSR is particularly eager to sell additional gas to Italy, even in reduced amounts, because other West European countries are buying less gas than Moscow had hoped. [redacted] 25X1

Mexico and Venezuela Announce Oil Price Hikes

Early this week Mexico and Venezuela announced price increases ranging up to $1.50 per barrel on their heavier crude oils. According to Embassy reporting, Mexico hiked its Maya crude by $1 to $24 per barrel while Venezuela increased the prices of its heavy and extra-heavy oil in a range of from 39 cents to $1.50 per barrel. The price increase on Maya crude—which

constitutes over one-half of Mexico's oil exports—could raise Mexico's annual oil revenue by as much as $275 million. Caracas has publicly stated it expects the increase to yield an additional $85 million for the government this year. Demand for these crudes has been fairly strong in recent months; their relatively low price has made them profitable for the growing number of refineries equipped to upgrade heavier oils into lighter products such as gasoline and diesel fuel. These crudes should remain attractive despite the price increase, which the press reports will be effective on 1 August. [redacted] 25X1

Lower Thai Natural Gas Reserves Confirmed

An independent estimate last week placed proved reserves in the Erawan field in the Gulf of Thailand at 628 billion cubic feet—slightly more than one-third of the originally estimated 1.6 trillion cubic feet. The new study [redacted] 25X1 supports Union's claims that Erawan—Thailand's only producing field—is not as large as originally believed and that the gas reservoir is fragmented into many small pockets, necessitating the drilling of additional costly wells. Although Bangkok had been prepared for a lower reserve estimate, the extent of the downgrading was much larger than most analysts expected. Thai officials must now face the possibility that other undeveloped fields in the Gulf of Thailand may be similarly fragmented and that total offshore reserves may be far less than the 16 trillion cubic feet estimated by PTT. [redacted] 25X1

International Finance

Nigerian Commercial Loan Arrearages Rescheduled

An agreement between international commercial banks and the Nigerian Government rescheduling approximately $1.6 billion in overdue short-term trade credit repayments was signed on 13 July in London. The agreement covers only one-fourth of Lagos's approximately $6 billion in overdue commercial bills. Moreover, the agreement contains no formula for providing much-needed new financing, although each bank has reportedly committed itself to bargain in good faith to provide new money. Under the terms of the agreement, Nigeria must come up with $500-600 million in interest arrears by 12 August if the agreement is to take legal effect. [redacted] 25X1 [redacted] 25X1 Nigeria does not have enough money to make the full payment; interest payments that are due in July on medium- and long-term debt will take priority on any available funds. [redacted] 25X1 it is unlikely that Nigeria would be declared in default because some banks will accept deferred payment enabling Lagos to pay the others. [redacted] 25X1

Officials in the Shagari government have been anxious to see Nigeria's precarious financial position stabilized and a steady flow of badly needed imports resumed. Already the agreement has received big headlines in the Nigerian press, and the government hopes to reap the political benefits in time for the 6 August presidential election. Although the rescheduling of arrearages

and the limited devaluation of the naira is welcome news for bankers, the lack of progress in the talks with the IMF may discourage some banks from extending new trade credits. [redacted] 25X1

Colombia Facing Growing Financial Pressure

Tightening credit and balance-of-payments problems are jeopardizing Colombia's status as the only major South American country to avoid debt rescheduling. [redacted] 25X1
[redacted] US Embassy reports 25X1
that most lenders are unwilling to extend additional short-term credit. The shortage of cash is becoming more severe because of declines in agricultural exports, capital flight, a drop in tourism receipts, and fewer remittances from Colombians abroad. Bogota is drawing down its liquid foreign exchange reserves, which have fallen by $857 million to some $1 billion during the first five months of this year. At the current rate, liquid reserves will be depleted by the end of the year. Without $600-800 million in new loans, Colombia probably will have to join other South American countries in rescheduling its external debt under IMF auspices. [redacted] 25X1

Global and Regional Developments

EC Steel Quota System Extended

The EC Council, following a drop in prices for some steel products, agreed on Monday to extend steel production controls until 30 January 1984. In May and again in June, EC industry ministers failed to reach a compromise on the extension issue. At the meeting this week, most member states supported the EC Commission's argument for a 30-month extension to safeguard prices for producers, but Italy objected. The Italian Minister of Industry maintained that Rome could not agree to a longer term arrangement before the new government takes office. [redacted] 25X1

Italy is likely to use agreement to future extensions as a source of leverage to limit EC reductions in Italian steelmaking capacity. As part of its reorganization of the steel industry in the EC, the Commission is demanding that Italy reduce its production capacity by 16 percent from the 36-million-ton capacity it had in 1980. Despite Italian tactics, the quota system probably will be extended again in January. Most EC members, including Italy, want to avoid lower prices induced by excess steel output. [redacted] 25X1

[redacted] 25X1

[redacted]

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National Developments

Developed Countries

Nakasone Orders Economic Stimulus Package

With Japan's trade surplus at record levels and its economic recovery still weak, Prime Minister Nakasone has ordered his Liberal Democratic Party to draw up a package of highly visible steps to boost the economy and increase imports. Reducing trade friction with the United States is especially urgent because of President Reagan's scheduled November visit to Japan. According to press reports, the measures will include:

- Expansion of agricultural imports.
- An increase in Nippon Telephone and Telegraph's overseas purchases.
- Financial and tax incentives for importers.
- Encouragement of housing construction.

The package is expected to be approved by the Cabinet in September. [redacted] 25X1

These measures are political window dressing. We believe they are unlikely to do much either to speed the economic recovery or to reduce the trade surplus. This year's government budget is austere, and the recently established spending ceiling indicates that fiscal policy will be even tighter next year. Because of its sheer size, the huge trade surplus will be little affected by the measures Nakasone is considering. [redacted] 25X1

Spain's Economic Performance

Midyear figures suggest that the Socialists will achieve few of the goals they set for 1983. The Bank of Spain estimates that the economy has been growing at an annual rate of only 1.2 percent, compared with the government's target of 2 percent. During the first five months, exports in dollar terms were down 8.2 percent from the same period a year earlier, pushing the trade deficit up by 7.6 percent to $4.9 billion. If this trend holds, the current account deficit this year could be close to $3.5 billion, far above Madrid's earlier projection of $2.5 billion. The loss of foreign exchange reserves may exceed $1.5 billion because Madrid has been unsuccessful in stimulating private-sector borrowing overseas. [redacted] 25X1

Consumer price inflation slowed to 11.7 percent in May, but planned price increases for basic commodities this fall probably will boost the inflation rate above the government's target of 12 percent by the end of the year. Although the unemployment rate has temporarily stabilized at 17.5 percent, the

Socialists have been careful to avoid promising any improvement. Madrid seems likely to maintain a relatively austere policy and has already indicated that workers should be prepared to accept real wage cuts next year. [redacted] 25X1

Less Developed Countries

Iraq Imposes Additional Austerity Measures

Baghdad is raising taxes and demanding additional sacrifices from an already war-weary population as it struggles to finance the conflict and meet minimum domestic needs. The government has raised the income tax to 25 percent, nearly a two-thirds increase over the old tax rate. [redacted] 25X1 [redacted] It also is conducting a campaign to collect "voluntary" 25X1 contributions of gold from Iraqi women. In addition, the government is using the gold drive to demonstrate public support for the war effort. Moreover, the regime has cut educational stipends and elementary school food programs. To reduce outlays of foreign exchange, Baghdad has delayed the issuance of import licenses for many nonessential consumer goods. It also has slashed imports of raw materials by two-thirds for private-sector industries, which produce domestic consumer goods. [redacted] 25X1

Increased income taxes and gold contributions will add to popular discontent without coming close to meeting Iraq's foreign exchange needs. Oil earnings this year will reach only $7 billion, as compared with about $9 billion last year and $25 billion in 1980. As a result, Iraq is likely to be left with a current account deficit of $12-15 billion, even after substantial cuts in imports. Direct aid by Persian Gulf states and oil sales by them on Iraq's behalf—providing perhaps $3-4 billion in additional revenue—will not close the gap. With foreign exchange reserves of less than $8 billion, Iraq will have to defer at least $4 billion in payments owed this year. [redacted] 25X1

New Kenyan Import Policy

Nairobi's new import policy implemented earlier this month is an attempt to satisfy requests by IMF and Western donors for a more rational allocation of the country's scarce foreign exchange. The previous program—in place since 1981—was marked by time-consuming bureaucratic procedures and corruption. The new policy provides automatic approval of all foreign exchange applications for certain essential imports including industrial raw materials, medicines, and agricultural products, while other goods are subject to licensing or other restrictions. Imports can be moved into a higher priority category every six months, depending on the availability of foreign exchange. [redacted] 25X1

Nairobi not only lacks the ability to ensure that funds are allocated properly, but we do not anticipate any quick, substantial infusions of foreign exchange needed to satisfy demand for imported consumer goods. As a result, merchants will continue looking for ways around the system, including altering invoices and bribing customs and bank officials. If, as we believe, Kenya is unable to gain control over import expenditures, the IMF and Western governments could become even more reluctant to provide financial assistance. [redacted] 25X1

Moroccan Austerity Measures Proposed

Morocco believes the austerity measures proposed in its revised 1983 budget will be sufficient for a second IMF standby loan. The new policies were discussed with an IMF team last week and include an exit tax on Moroccans, a freeze on government hiring, an increase in the Saharan War tax, a cutback in investment projects, and a reduction in consumer subsidies. An extraordinary session of parliament was convened on Tuesday to approve the austerity measures; the government hopes public discussion will defuse unrest and avoid a repeat of the 1981 riots sparked by food subsidy cuts. 25X1

Thai Trade Deficit Widens

The merchandise trade deficit reached about $1.4 billion for the first half of 1983—up sharply from the $336 million in the same period last year. Export earnings fell 18 percent because of depressed international commodity prices and the poor 1982/83 harvest in which the production of all major crops except rubber fell. Imports rose 10 percent, stimulated by the beginnings of an economic recovery and lower interest rates. On the basis of the first-half performance, the Central Bank's estimate of a $2.1 billion trade deficit looks overly optimistic; the deficit may reach $2.6 billion if international commodity prices do not rise substantially in the coming months. Concerned about this possibility, Bangkok is considering measures to boost exports, including reducing trade taxes and the royalty on tin, according to the local press. 25X1

Communist

East German Economy Registers Moderate Growth

East Germany in mid-July claimed increased growth in the first half of 1983, compared with the same period last year. National income reportedly grew 4.0 percent and industrial production 3.8 percent, both up from 3.0 percent in first-half 1982. East Berlin attributed much of the improvement to gains in labor productivity and greater efficiency in the use of energy and raw materials. Although the data suggest that the economy has partly recovered from the dislocations caused in 1982 by the regime's reductions in Western imports, we believe they may convey an overly optimistic picture. The East German report shows some of the same inconsistencies as last year, when we calculated that the claimed 3-percent growth in national income for the entire year translated into real GNP growth of only 0.5 percent, the lowest in Honecker's 12-year tenure. The data in the report do not adequately identify the sources of the modest recovery in growth, but suggest that it could result from an increase in net exports. First-quarter partner country trade data—including Soviet data—are significantly at odds, however, with East German claims of a 15-percent growth in exports. East Berlin's admission that retail sales did not grow tends to corroborate reports of continued shortages of consumer goods and suggests the standard of living has continued to decline. 25X1

Respite in Flooding in China

Beijing has announced that water levels in all major rivers are now below warning levels after a month of serious flooding in central and eastern China. Although national estimates of damage have not been published, US officials in Beijing have been notified that the flooding was not as serious as reported in the press, and China would prefer that the United States not offer aid. [redacted] 25X1

Favorable weather is expected over most of China into mid-August, which will aid peasants in draining fields. Crops in central and south China are beginning to show visible signs of waterlogging which, if prolonged, will reduce late harvest yields. The early rice harvest was reduced in these areas because of cool, wet weather, but grain supplies remain adequate because of last year's record harvest. [redacted] 25X1

Zaire: President Mobutu's Visit [redacted] 25X1

Zairian President Mobutu will visit Washington in early August for meetings with President Reagan and other top US officials. He is likely to appeal for greater security and economic assistance, arguing his case by pointing to his military support for the beleaguered pro-Western regime in Chad and to recent Zairian economic and political reforms. Mobutu's visit comes at a time when his position at home appears secure. [redacted]

Mobutu's Perspective on Chad

Developments in Chad are likely to be foremost on Mobutu's mind, according to the US Embassy in Kinshasa. The 1,500- to 1,750-man Zairian force in Chad is assigned primarily to help protect the Chadian capital, but Mobutu's orders also state that President Habre may use the Zairian troops in any way he sees fit. Zairian fighter aircraft, meanwhile, may be conducting limited reconnaissance for Habre's forces, and a Zairian C-130 transport aircraft has flown logistic missions for the Chadians. [redacted]

We believe Mobutu will urge that a major portion of the recently authorized $10 million in US emergency military assistance for Habre be channeled to Zairian units in Chad, many of which are poorly equipped. He may also press for increased direct US support to the Zairian armed forces; indeed, he may bring a specific military shopping list to Washington. [redacted]

In pressing for greater military assistance, Mobutu may stress that Kinshasa needs to be compensated for the military and financial resources it is expending in Chad at a time when Zaire is trying to cope with severe budgetary problems. [redacted]

[redacted]

[redacted] 25X1

Mobutu's Economic Agenda

Mobutu probably also hopes that he can parlay his government's defense of Western interests in Chad into increased US economic assistance. During his talks in Washington, he is likely to point to significant economic and administrative reforms he has instituted during the past year. These measures, recommended by the International Monetary Fund and Western donor nations, have included: 25X1

- New limitations on government spending, including a pay cap on public-sector salaries, aimed at reducing the budget deficit.
- Improved accounting and marketing arrangements for cobalt and copper, designed to reduce opportunities for corruption in these key industries.
- Removal of most controls on farm prices and liberalization of restrictions on the movement of agricultural commodities—actions aimed at stimulating agricultural production. [redacted] 25X1 25X1

Support for a New IMF Accord

Mobutu is likely to urge that Washington respond to such efforts by interceding with the IMF to speed negotiations now under way for a one-year standby loan of nearly $250 million and a compensatory fund facility of about $110 million.[1] He may 25X1

[1] Zaire's last IMF program, a three-year $1.1 billion loan agreement approved in June 1981, lapsed after only five months when Kinshasa failed by a wide margin to meet the Fund's performance targets. [redacted]

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argue that his government already has accepted most of the reforms the Fund is urging and that delay in reaching an agreement would result in increased hardship for the Zairian people.

Fund officials, for their part, generally appear satisfied with Mobutu's reform efforts, according to the US Embassy in Kinshasa. The Embassy believes the principal remaining issue—reform of the country's exchange rate system, including a large devaluation—is close to resolution

Increased Bilateral Aid

While in Washington, Mobutu may also solicit greater bilateral economic assistance. The United States furnished approximately $24 million in economic aid during FY 1982; such assistance has totaled about $625 million since Zaire's independence in 1960. US military aid deliveries to Zaire were about $7.6 million in FY 1982 and have totaled around $115 million since 1960. In recent years, the United States has provided PL-480 food, aid to agricultural and rural development, and assistance in nutritional and health fields.

In appealing for greater assistance, Mobutu may argue that:

- Increased aid is necessary during the current period of difficult economic adjustments.
- Zaire's economic problems result largely from external factors—worldwide recession and falling commodity prices—over which Kinshasa has no control.
- The present level of assistance is inconsistent with the two countries' historical ties as well as with Zaire's importance and pro-Western orientation.
- The United States tends to take Zaire for granted and in some instances provides greater assistance to less consistent supporters of Washington's positions on foreign policy issues.

Mobutu also may ask that Washington back his government's efforts to get public and private creditors to reschedule Zaire's $4.5 billion medium- and long-term debt. Western nations and private banks have periodically rescheduled Zaire's debt since 1976, and the Zairians doubtless hope that they will receive more such relief once they come to terms with the IMF. 25X1

Other Economic Concerns

Mobutu may ask that Washington make additional purchases of Zairian cobalt for the US strategic stockpile, contending that the United States should take advantage of current low world cobalt prices and Kinshasa's willingness to make such sales on concessional terms. He may also point out that such purchases would assist his government by reducing Zaire's 25,000-ton stockpile of unsold cobalt and by putting Kinshasa in a better position to repay its debts. At the same time, he may voice concern over recent reports that the Congress plans to consider legislation to subsidize domestic US cobalt producers. The United States imports more than 90 percent of the cobalt it uses, and nearly 60 percent of the imported cobalt comes from Zaire. 25X1

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Mobutu may express interest in greater US trade and investment. US private foreign investment in Zaire in 1981 totaled about $123 million, according to the US Commerce Department. The United States and Zaire are currently involved in difficult negotiations on a bilateral accord aimed at facilitating increased investment. 25X1

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Economic Outlook

In the near term, we expect that Mobutu will undertake only those economic reforms necessary to secure continued Western financial support. He probably recognizes that he has few other options. Even with such assistance, however, he probably will be able to do little more than slow Zaire's economic decline until the international economic recovery under way results in significantly higher mineral prices. Moreover, the presence of large cobalt and copper stockpiles in some countries, as well as the availability of substitutes, will tend, at 25X1

least initially, to dampen pressures for major price increases. [redacted] 25X1

Over the longer term, we are skeptical that Mobutu will display the political will needed to pursue the strong belt-tightening and other measures that might turn the economy around. He has adopted economic reforms in the past with little lasting effect, and we doubt that the current recovery program will fare much better. [redacted] 25X1

[redacted] 25X1

Nigeria: The Economy Under Civilian Rule [1] [redacted]

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Heightened tensions associated with national elections scheduled to begin next month will severely test the survivability of the Shagari government and Nigeria's still untested democratic institutions. We expect the next month to be turbulent, but, on balance, we believe President Shagari has a fairly good chance to win. Even if he wins reelection, however, he still will face troublesome political problems and be forced to make difficult economic decisions. [redacted]

Although sharply reduced oil revenues over the last two years have put Nigeria in an increasingly precarious economic position, election concerns have deterred Shagari from implementing stringent economic measures needed for recovery. [redacted]

We expect Nigeria will reach an agreement with the IMF after the elections, but only after protracted and difficult negotiations. Implementation of the needed structural reforms may be hampered by corruption and inefficiency in the government. Oil production has rebounded terporarily to well over 1.5 million barrels per day, but is expected to fall back to within the OPEC quota. As a result, government revenues for 1983 are still likely to be roughly 15 percent below last year. So far, rising inflation, unemployment, plant closings, and shortages of imported goods have not sparked widespread demonstrations, but we believe that urban tempers could boil over as economic woes continue to mount. We anticipate that Lagos in the near term will appeal to the United States to help rescue Nigeria's flagging economy by interceding with the IMF and providing food assistance. [redacted]

[redacted]

Declining Economic Performance

Shagari and his key economic advisers have been slow to respond to Nigeria's rapid economic decline, which was unanticipated when civilian rule was reinstated in 1979. The new leaders assumed that oil prices and production would climb steadily and that increasing revenues would sustain economic growth and allow Nigeria to finance its ambitious development plans. This optimism was fueled by an average annual growth in real output of 5.5 percent between 1975 and 1980, foreign exchange reserves of well over $5 billion in 1979, and a relatively modest official inflation rate of 11 percent. However, even during the first two years of civilian rule when economic indicators looked good, potential economic growth was reduced by corruption, mismanagement, and inefficiency. Moreover, the government has made no headway in diversifying Nigeria's oil-dependent economy. We estimate, for example, that oil still accounts for 80 percent of government revenues and over 95 percent of exports. [redacted]

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The current economic crisis stems in large part from diminishing government revenues caused by the worldwide drop in the demand for oil that began in 1981 as well as unsound economic policies. Nigerian oil production in 1981 and 1982 was 30 percent and 37 percent, respectively, below the 2.1-million-barrel-per-day average in 1980. The US Embassy reports that oil revenues in 1981 were only about two-thirds of those projected initially by the Nigerian Government, while revenues last year were only one-half those the Shagari administration was counting on. Nigeria's price cut in February of $5.50 per barrel and OPEC's pricing and production agreement a month later helped boost

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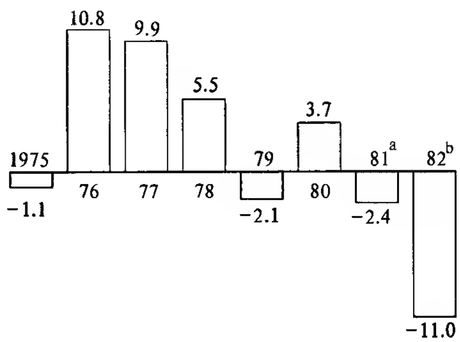
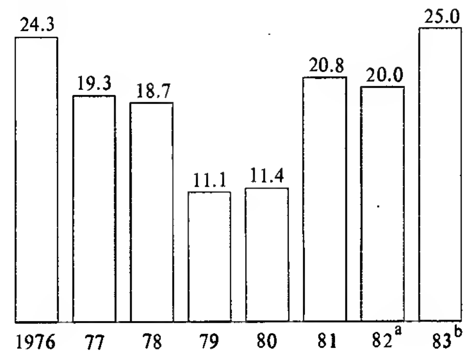
Nigeria: Selected Economic Indicators

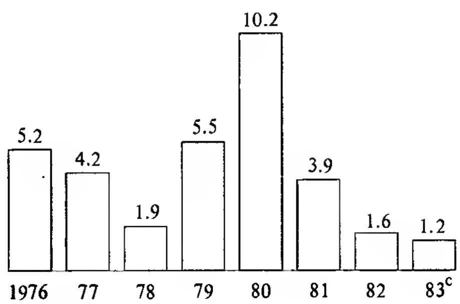
Real GDP Growth
Percent



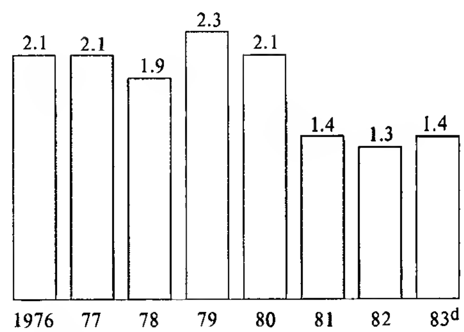
Consumer Price Inflation
Percent



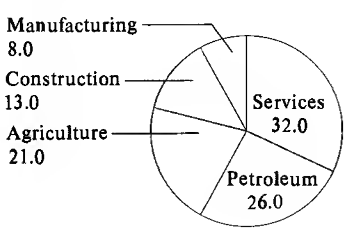
Foreign Exchange Reserves, Yearend
Billion US $



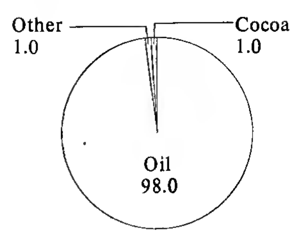
Oil Production
Million b/d



Composition of Real GDP, 1981
Percent



Composition of Exports, 1981
Percent



[a] Estimated.
[b] Projected.
[c] May 1983 data.
[d] 2nd quarter.

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average production back to 1.4 million barrels per day in the second quarter, but we estimate that it will be difficult for Nigeria to meet its financial commitments without increased outside assistance.[2] [redacted]

The downward economic spiral in the last two years reflects Nigeria's overdependence on oil revenues and the government's inability to reduce spending significantly in the face of hard economic times. We estimate that real GNP contracted by 11 percent last year while the current account deficit was over $3.5 billion. Nigeria registered a $9 billion trade surplus in 1980 but an $800 million deficit in 1982. Foreign reserves fell from more than $10 billion at the end of 1980 to around $1.2 billion in May of this year—enough to cover about six weeks' imports. Finally, Nigeria's total debt has climbed from a relatively modest $5 billion in 1979 to almost $15 billion, including, according to the US Embassy, more than $4 billion in short-term arrears. [redacted]

The Shagari administration has, in our judgment, preferred to hope for increased demand for oil or new international bank loans rather than make the painful adjustments required to stem the current economic slide. For example, although a Nigerian official now reports that imports have been cut to about $900 million per month—from an average of about $1.6 billion before austerity measures were announced in 1982—it has taken the government over a year to achieve this target and even then it has been accomplished in large part because the government has run up arrears and cannot get further credit. [redacted]

The government has not—despite the steady flow of bad economic news and gloomy predictions—formally scaled back development plans or effectively reevaluated economic priorities. US Embassy reporting indicates that, although the Fourth Development Plan—initiated in 1981 and based on an expected five-year oil income of over $125 billion—is floundering and probably will be scrapped after the election, both the government and opposition parties continue to promise to implement costly social and economic projects. The government is still publicly committed to moving ahead with highly touted projects that could be postponed, such as a liquified gas plant, the Soviet-built Ajaokuta steel works, and the new federal capital in Abuja. There is widespread agreement among knowledgeable analysts that Ajaokuta—now far behind schedule—will never produce competitively priced steel. [redacted] 25X1 25X1

The country's dwindling resources are further strained by the need for food imports and the inability of the Shagari government to make good on its 1979 campaign promise to move quickly toward food self-sufficiency. The US Embassy reports that agricultural production—badly neglected since the outset of the oil boom in the early 1970s—recently has been growing by about 2 percent per year, but this is largely due to improved weather conditions and, in any case, is far below the targeted growth of 4 percent per year and the population growth rate of 3.4 percent annually. Skyrocketing food demands in rapidly growing cities have left the government with little choice but to import staple commodities. Nigeria imported about 600,000 tons of rice in 1982, for example, compared to less than 100,000 tons in the 1960s. Last year's food imports cost about $2 billion, and this year Nigeria has been forced by foreign exchange shortages to buy cheaper Thai rice rather than higher quality US rice. [redacted] 25X1 25X1 25X1

In our judgment, government failure to implement sound economic policies and thereby control the economic situation also is complicated by endemic corruption and bureaucratic inertia and inefficiency. [redacted] 25X1

[redacted] almost all contracts let by the federal government require a substantial kickback to the National Party coffers. [redacted] 25X1 25X1 25X1 25X1

[2] This estimate is based on the premise that Nigeria will meet its 1.3-million-barrel-a-day OPEC quota and that the price of Nigerian crude will remain at about $30 per barrel. [redacted]

[redacted] Similar kick-back standards apply at the state level, including those states controlled by opposition parties. [redacted]

Extensive corruption in awarding import licenses—one of the most lucrative forms of graft in Nigeria—also hampers government efforts to limit import spending and to establish a systematic priority list for foreign purchases. Moreover, US Embassy economic reporting indicates that luxury items continue to be imported while essential commodities such as industrial raw materials and spare parts are in increasingly short supply. Construction and manufacturing companies have been particularly hard hit; both Peugeot and Volkswagen, for example, are forced to shut down periodically because of a lack of spare parts or foreign exchange. A number of foreign firms have cut back or begun to pull out of Nigerian operations in the face of these problems, thus further weakening the economy. [redacted]

Economic Challenges

In our judgment, civilian leaders face a difficult challenge in 1983 as they wrestle with the need to take far stronger corrective economic steps without endangering their grip on political power. Prior to the election, we believe the Shagari administration, rather than risk politically painful austerity measures, will continue its band-aid approach to the economic crisis. [redacted]

We believe Shagari's closest financial advisers now realize that there are no quick remedies for Nigeria's economic difficulties. Recent increases in oil production, a rescheduling of a part of the short-term commercial arrears, and possible access to new loans from international banks may give Nigeria more money than expected at the beginning of the year. Even so, we believe the government's room to manuever its way around the current economic mess will remain circumscribed without a significant turnaround in the worldwide demand for oil. In our judgment, corruption and mismanagement coupled with the lack of clear economic priorities and perceived political constraints will continue to work against economic reform and undermine the impact of austerity measures. As a result, we believe Nigeria will reach an agreement with the IMF after the elections, but negotiation of a workable adjustment program is likely to be difficult and a program will require stringent implementation. If Lagos falters, we anticipate that the economy will continue to stagnate or decline even further as leaders attempt to negotiate new agreements with the Fund and commercial banks. [redacted]

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In any case, we do not believe the Nigerian economy will recover quickly enough to ameliorate the economic and social dislocations in potentially volatile cities. US Embassy reporting has documented a marked deterioration in living standards, including increases of over 65 percent in the price of such consumer staples as rice, yams, chicken, and palm oil during the first three months of this year. [redacted] urban unemployment may now be as high as 30 percent, double what it was a year ago. We believe that plant closures are likely to top last year's rate when Nigerian labor and industrial organizations estimated that at least 45 industries laid off employees or shut down, idling more than 150,000 workers. The head of the Nigerian Labor Congress claims that over 200,000 of an estimated 3 million organized workers have lost their jobs since the government introduced austerity measures last year, and he has promised to resist strongly any proposals that call for wage freezes, strike bans, and increased working hours. [redacted]

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Despite tough conditions, relatively little serious, economically inspired protest has materialized so far. A widespread extended family system—where

better-off members are obligated to aid their less fortunate relatives—and a large underground economy have helped cushion the impact of the current recession. Continuing economic shocks, however, in our judgment, will test the resilience and patience of urban dwellers and could spark antigovernment protests. The US Embassy, for example, has reported that the government is particularly sensitive to the political risks that could arise from any widespread food shortages.

In the past, restive students and labor have provided early warning signs of widening popular dissatisfaction with the government. At present, however, there is little reporting to suggest that unions or students—both closely monitored by the government and divided among themselves—could carry out sustained strikes or demonstrations capable of bringing down the government. The US Embassy also notes that these groups represent only a relatively small percentage of the population and that, thus far, strikes have been relatively isolated and short-lived, while student demonstrations have focused more on campus issues. Despite this, student and labor groups tend to be more politically active and relatively better organized, and, in our judgment, have the potential to provoke widespread urban unrest that could tax the government's ability to maintain order. This could serve as a pretext for a military attempt to overturn the government if it appeared that the civilian leaders had lost control of the situation.

Implications for the United States

In our judgment, Nigeria's economic performance, at least throughout the remainder of the year, will continue to fall short. As a consequence, we believe Nigeria will look to Washington to take more decisive action to help bail the country out of its current economic mess and will expect US treatment similar to that received by Mexico or—at least—Brazil. US Embassy reporting indicates that Nigerians believe Washington has an obligation to help preserve their American-style political system as well as to repay Lagos for support on numerous international issues, including its refusal to join the 1973 Arab oil embargo. Requests are likely to include calls for Washington for possible emergency food aid and intercession with the IMF on Nigeria's behalf. Lagos, for example, requested a $150 million commodity credit guarantee earlier this year to help tide the country through 1983 but only $30 million was approved. We expect further requests if reported spot food shortages become more widespread. 25X1

At the same time, however, Nigeria's strident nationalism and leadership ambitions in Africa make it difficult for Lagos to appear to be too dependent on or allied with the United States. We believe that if Washington appears unconcerned about Nigeria's problems or if aid packages do not meet Lagos's expectations, Shagari could feel compelled to distance himself to some degree from the United States during his second term. In view of Nigeria's present economic straits, however, we do not foresee Lagos making direct threats against US economic interests or shutting off access to Nigerian crude oil. Nor does there appear to be a strong lobby within Nigeria's civilian elite that advocates closer ties to the Soviet Union or Libya, or that favors attempting to blackmail the United States and the West into providing more aid. In our view, Nigeria would be more likely to reduce its support for US African policies, especially in southern Africa, and to counsel other African states to do likewise. 25X1

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Iranian Natural Gas: An East-West Issue [1] [redacted]

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Iran's enormous natural gas reserves—exceeded only by the Soviet Union's—have been viewed as a potential source of supply to Western nations, particularly by countries in Western Europe. Iran's gas export potential, however, is limited by a number of economic, financial, and technical constraints. The economics of transporting Iranian gas long distances make the Soviet Union the most likely outlet for Iranian gas in the foreseeable future. We believe the Soviets are concerned that Iran could become a potential competitor in the West European market; by purchasing Iranian gas and attempting to expand sales of its own gas to potential Iranian customers in Greece and Turkey, Moscow no doubt hopes to minimize the potential competition. [redacted]

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The Resource Base

Iran's natural gas reserves place Iran second only to the USSR in total proved reserves. According to the most recent industry estimates, Iran's proved reserves are over 10,000 billion cubic meters (bcm). More than 50 percent of reserves are found in association with oil in the Khuzestan fields in southwestern Iran. Huge deposits of nonassociated gas are located in the southeast near Kangan. Smaller gasfields are located in two other areas of the country—in the northeast at Sarakhs and Khangiran and around Qeshm Island and Bandar Abbas, near Iran's southwest coast. Industry analysts believe additional exploratory drilling could substantially boost estimates of Iran's natural gas reserves, potentially doubling reserves of nonassociated gas. [redacted]

[redacted]

Iran: Estimated Natural Gas Reserves by Field [a]

Billion cubic meters

	Proved	Ultimately Recoverable
Total	**10,400**	**16,573**
Associated		
Khuzestan oilfields	5,728	5,728
Nonassociated	4,672	10,845
Pars (C structure)	1,529	2,123
B, F, G structures	1,161	5,493
Nar	396	595
Kangan	311	595
Khangiran	510	510
Sarakhs	85	595
Qeshm (Gavarzim and Salakm)	113	226
Sarkhun	142	283
Others	425	425

[a] Based on 1977 official reserve estimates of the National Iranian Gas Company. Subsequent depletion of 218 bcm has been taken into account.

[redacted]

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Production Options

Most of Iran's gas production is associated with crude oil production. Consequently, Iranian gas output in recent years has fluctuated widely in line with wide swings in oil production. Iran is presently producing a total of about 35 bcm per year, over half of which is flared. [redacted]

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Given the size of Iran's natural gas reserves, [redacted] Iran has the potential to produce

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Iran: Natural Gas

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Iran: Estimated Gas Production and Use [a]

Billion cubic meters per year

	1976	1977	1978	1979	1980	1981	1982 [b]	Current [c]	1990 [d]
Gas production	**50**	**57**	**55**	**40**	**20**	**17**	**28**	**35**	**100**
Flared	28	26	26	16	9	8	16	20	10
Reinjected	1	9	10	4	2	2	2	2	30-42
Marketed production	21	22	19	20	9	7	9	13	48-60
Domestic	11	12	12	15	8	7	9	13	39
Oil industry	4	4	4	3	2	1	1	3	4
Petrochemical	2	3	3	3	2	1	1	1	12
Domestic/commercial industrial	2	3	4	5	3	4	6	7	18
Shrinkage and loss	2	2	2	2	1	1	1	2	5
Exports	9	9	7	5	NEGL	0	0	0	9-21

[a] Due to rounding, components may not add to totals shown.
[b] Associated gas production estimated at oil production levels of 2.5 million b/d.
[c] Associated gas production estimated at oil production levels of 3.0 million b/d.
[d] Associated gas production estimated at oil production levels of 3.5 million b/d. Assumes all associated gas production reinjected or flared and gas reinjection plans for nonassociated gas are implemented.

[redacted] 25X1

more than 100 bcm per year of gas by 1990, a rate that could be sustained for at least a decade. According to industry data, Iran's ability to reach this level would depend on the country's oil production and development of nonassociated gasfields. If oil production stabilizes at 3.5 million b/d, Iran would probably have to produce over 50 bcm from nonassociated gasfields. Nonassociated gas production at this level would eventually force Iran to develop the giant offshore Pars field. [redacted]

The amount of gas available for export at this level of production would depend in part on Iranian plans for domestic consumption. [redacted] Iran has extensive plans for expanding industrial and residential gas use and gas reinjection. Beginning this year Iran plans to implement a $1.6 billion gas reinjection program—requiring the development of nonassociated gasfields—to maintain reservoir pressures in its Khuzestan oilfields. The reinjection program, if successfully implemented, will require 30 to 40 bcm per year. As a result, we believe Tehran would have roughly 50 to 60 bcm of gas per year for other domestic needs or exports by 1990. In any case, exports are likely to be limited by Tehran's inability to find customers. [redacted] 25X1

Finding Western Outlets in the 1980s

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Turkey last year proposed that Iran supply Western Europe with up to 35 bcm of gas per year for 25 years through a pipeline network crossing Turkey into Greece and southern Europe. While meeting all of Turkey's natural gas needs of 6.5 bcm per year, Iran would also provide over 25 bcm to West European markets. [redacted]

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Moscow apparently has decided to challenge an Iran–to–Western Europe gas pipeline scheme by competing directly for the southern European gas markets in Turkey, Greece, and Italy. In particular, the Soviets recently signed a joint protocol with Istanbul setting up a pipeline feasibility study on the export of gas from the USSR to Turkey. This move came on the heels of extensive press reporting of the potential Iran-Turkey gas deal. Discussions are also under way between Moscow and Athens on extension of the Soyuz pipeline from Bulgaria into Greece. According to official Greek press releases, an agreement is in the final stage of negotiation. In addition, the Soviets continue to negotiate with the Italians on deliveries of Siberian gas. These efforts could effectively block Iranian access to the larger European market by limiting the amount of gas that Tehran could sell in transit.

By virtue of their geographic location, countries in southern Europe—particularly Turkey, Italy, and Greece—would be the most natural markets for Iranian gas. Italy already receives ample supplies of imported gas from three other sources, however, and gas demand in Greece and Turkey is relatively small because of the lack of an extensive gas infrastructure. Still, the markets in Turkey and Greece are key steppingstones for Iranian entry to the larger West European market because Tehran will need to sell gas in transit to minimize the cost of delivery. All the other major West European gas purchasers, moreover, already have contracts in hand for sufficient gas supplies to meet projected needs in the 1980s, leaving virtually no room for Iranian sales.

Iran's potential to supply countries in the Far East in this decade—particularly Japan, South Korea, and Taiwan—also is limited by competition from other suppliers, especially Indonesia. Japan has contractual obligations with six countries for LNG supplies that should meet all of its gas requirements well into the 1990s. We believe the markets for gas in South Korea and Taiwan are relatively small and are likely to be met by other suppliers in the region.

We believe there is also little opportunity for Iranian gas to penetrate the US gas market in this decade. According to Department of Energy estimates, 90 percent of US gas consumption needs—amounting to 540 bcm in 1990 and 517 bcm in the year 2000—will be met by domestic production. Canada has licenses to supply another 6 percent and has shown willingness to supply incremental volumes at competitive prices. Mexico is also in a favorable position to supply the US market, and Algeria has contracts for delivery of small volumes of LNG to the United States.

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Looking to the 1990s

Unless some sort of political decision is made on the gas pricing front, the high cost of Iranian gas is likely to keep Tehran out of Western markets in the 1990s when forecasts indicate that import requirements will grow. The most reliable industry estimates we have seen indicate that the cost to produce Iranian gas and deliver it by pipeline to Western Europe would be about $4 per million Btu. Assuming Tehran continues to demand a wellhead price of more than $2 per million Btu, as they have in recent negotiations, the delivered price of gas to Western Europe would exceed $6 per million Btu. As things now stand, Iran does not appear prepared to accept the low return on its resources that would be required to deliver gas to Western Europe at a price competitive with Soviet supplies or competing oil products—about $4.60 per million Btu.

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LNG delivery costs would also be quite high for Iran because of long distances from potential markets. We estimate that LNG transported from the Mediterranean port of Iskenderun to southern Europe would cost at least $5 to $5.50 per million Btu to produce, deliver, and meet Iranian wellhead pricing demands. Shipment to Western Europe around the Cape of Good Hope from the Persian Gulf would increase costs by about $1 per million Btu. The delivered price of Iranian gas to the Far East would probably exceed $5 per million Btu and Iranian LNG to North American markets would easily exceed $6 per million Btu. In all these

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markets, the cost of Iranian LNG would exceed the price of most alternative gas supplies and other competing fuels. [redacted]

Iran also lacks the technical ability to develop the large offshore nonassociated gasfields that must be brought on stream to support a major export project. [redacted] Tehran lacks the specialized equipment and skilled crews to handle the high pressure gas in Pars, and development would almost certainly entail extensive Western assistance. We doubt that the present Iranian Government would be willing to accept the foreign involvement that would be needed to overcome the technical constraints. [redacted]

The Soviet Option

Given the limited Western markets, Tehran's most attractive gas export option is to renew its gas delivery agreement with the Soviet Union. We estimate that it would cost Iran only about $1.50 per million Btu to deliver gas to the Soviet Union through an existing pipeline. Although the USSR has the largest natural gas reserves in the world, Moscow found it advantageous to import Iranian gas rather than build the infrastructure necessary to ship domestic supplies to the gas-deficient republics of Armenia and Georgia near the Iranian border. Tehran delivered about 9 bcm per year to the Soviet Union through the IGAT I pipeline until a price dispute—spurred in part by allegations that Moscow was selling gas on the West European market at prices higher than the Iranian purchase price—caused all gas deliveries to be terminated in 1979. [redacted]

We believe Iranian gas still has considerable appeal to Moscow. According to [redacted] industry trade journals, the Soviets approached Tehran to resume exports late last year. Although [redacted] the Soviets have begun to build the infrastructure necessary to supply gas users in the southern Caucasus, gas imports of about 10 bcm per year from Iran could provide Moscow with a relatively inexpensive means to supply the region by eliminating the high cost of shipping domestic supplies. Imports of Iranian gas to the southwest would allow Moscow to divert gas for use elsewhere in the country or for export to Western Europe. [redacted] 25X1 25X1

In our view, other motivations for finalizing a deal would be Soviet desires to establish closer commercial links with Iran and to preempt the possibility of an Iranian deal with any West European government for the 1990s. Although the economics for a West European–Iranian deal are not favorable, Moscow almost certainly recognizes that a political decision could be made that would overcome the economic and financial constraints. By importing Iranian gas, Moscow would also siphon off some of the most readily accessible gas that Tehran would have available for export to Western Europe. [redacted] 25X1 25X1 25X1

Some obstacles must be overcome, however, before exports are resumed. Tehran and Moscow still need to reach an agreement on the price of gas deliveries and method of payment, issues that have gone unresolved for the past four years. Trade journals indicate that the Soviets have offered Iran $3.50 per million Btu; Tehran so far has balked at the offer, demanding a minimum of $3.80 per million Btu. We believe Moscow also would probably have to assure Tehran that it would not swap Siberian gas in Western Europe at a price above the level Iran receives for its gas. Negotiations remain deadlocked, and the recent explusion of Soviet diplomats and the banning of the Communist Tudeh Party by Tehran have further strained relations between the countries. [redacted] 25X1

Western Options

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Over the next several years, weak international gas prices could make the Soviet option more attractive. The high cost of delivering Iranian gas to the West would result in prices that are probably too high to attract large customers or too low to provide acceptable profits to Tehran. In the absence of Iranian willingness to accept lower gas prices, we 25X1 25X1 25X1

believe the only likely manner in which West European purchasers could obtain Iranian gas is to make a political commitment to subsidize a gas export project. Such a commitment would entail considerable costs because Iranian gas is likely to cost about $1 to $2 per million Btu more than alternative supplies. [redacted] 25X1

[redacted] 25X1

Eastern Europe: Future Demand for Soviet Natural Gas

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Although Eastern Europe is planning to buy more natural gas from the Soviet Union over the coming decade, it may well take less than the USSR would like to deliver. Gas demand in Eastern Europe is constrained by reduced economic activity. Stagnating economic growth and declining rates of investment are slowing the pace of converting from oil to natural gas. Soviet pressures to buy more gas—and thus free up more oil for hard currency sales to the West—could force the East Europeans to make the investments needed to allow them to step up purchases sooner than they would like.

The USSR exported only about 2 billion cubic meters (bcm) of natural gas annually to Eastern Europe at the start of the 1970s. Deliveries increased to about 16 bcm by 1978, then jumped to 29 bcm in 1980 when the Orenburg pipeline was completed. As compensation for work on the pipeline, each country was scheduled to receive 2.8 bcm annually with the exception of Romania, which was to receive only 1.5 bcm for its more limited participation. Some countries—most notably Bulgaria—were not prepared to receive their full allotment, leaving 1980 deliveries about 2 bcm below plan.

Gas shipments from the USSR exceeded 30 bcm last year and accounted for virtually all of Eastern Europe's gas imports (Romania ships just 200 million cubic meters annually to Hungary). Soviet gas accounts for more than one-third of gas consumption—well over one-half if Romania is excluded—and almost 6 percent of total primary energy consumption.

The Soviets would like to step up gas shipments sharply to Eastern Europe by the end of the decade. With Soviet gas production climbing by as much as 45 percent by 1990, Moscow will be able to boost the share of gas in domestic energy consumption and still have a large exportable surplus. Total exports could double by 1990 to 120 bcm annually, with half of this amount available for Eastern Europe. The Soviets would like to boost gas sales to Eastern Europe and cut oil deliveries further in order to free more oil for hard currency sales; Moscow currently supplies Eastern Europe with nearly 1.5 million b/d of oil at subsidized prices.

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Future Gas Demand

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Despite the potentially important role for Soviet gas in Eastern Europe's energy picture, current East European plans through 1990 fall short of Soviet targets for gas deliveries. At present, only three of the East European regimes—Bulgaria, Czechoslovakia, and Poland—have published plans that anticipate additional deliveries of Soviet gas beyond this year's levels. These three countries expect to increase their imports of natural gas from the USSR by at least 15 bcm by 1990, an 85-percent increase over 1982 deliveries:

- Sofia hopes to double its gas imports to 10 bcm annually over the next several years; imports could climb even higher by 1990. As much as 1.5 bcm of this additional gas, however, is apparently linked to the Orenburg project. 25X1
- Prague officials told the US Embassy that they may receive as much as 4 bcm annually as compensation for the new Siberia-to-Western Europe pipeline crossing Czechoslovakia. The final amount probably will depend on the volume of gas Western Europe eventually purchases, but will be at least 2 bcm. 25X1

Eastern Europe: Natural Gas Balances [a]

Billion cubic meters

	1970	1978	1979	1980	1981	1982	1983 [b]	1990 [b]
Totals								
Production	**35.4**	**58.6**	**55.6**	**55.1**	**56.6**	**56.9**	**57.9** [c]	**54.1-56.1** [c]
Soviet deliveries	**2.3**	**16.2**	**21.9**	**29.4**	**29.9**	**30.4**	**31.0**	**46.0-47.0** [d]
Apparent consumption	**37.7**	**74.8**	**77.5**	**84.5**	**86.5**	**87.3**	**88.9** [c]	**100.1-103.1**
Bulgaria								
Production	0.5	NEGL	0.1	0.2	0.1	0.1 [c]	0.1 [c]	0.1 [c]
Soviet deliveries [c]	0	3.0	3.1	4.0	4.4	4.5	5.0	10.0 minimum
Apparent consumption	0.5	3.0	3.2	4.2	4.5	4.6 [c]	5.1 [c]	10.1 [c] minimum
Czechoslovakia								
Production	1.2	1.1	0.9	0.6	0.7	0.7	0.8 [c]	1.0 [c]
Soviet deliveries [c]	1.3	5.8	7.3	8.3	8.6	8.5	8.5	12.5
Apparent consumption	2.5	6.9	8.2	8.9	9.3	9.2	9.3 [c]	13.5 [c]
East Germany								
Production [c]	1.2	8.5	8.5	8.5	8.5	8.5	8.5	10.0
Soviet deliveries	0	3.6	4.4	6.4	6.3	6.5	6.5	6.5 minimum
Apparent consumption	1.2	12.1	12.9	14.9	14.8	15.0	15.0 [c]	16.5 [c] minimum
Hungary								
Production	3.5	7.3	6.5	6.1	6.0	6.6	6.8 [c]	6.5 [c]
Soviet deliveries	0	1.0	2.5	3.8	3.8	3.8	3.5	3.5-4.5
Apparent consumption [e]	3.7	8.5	9.2	10.1	10.0	10.6	10.5 [c]	10.0-11.0 [c]
Poland								
Production [d]	5.0	8.0	7.3	6.3	6.2	5.5	5.5 [c]	1.5-3.5 [c]
Soviet deliveries	1.0	2.8	3.9	5.3	5.3	5.6	6.0	12.0
Apparent consumption	6.0	10.8	11.2	11.6	11.5	11.1	11.5 [c]	13.5-15.5 [c]
Romania								
Production	24.0	33.7	32.3	33.4	35.1	35.5	36.2 [c]	35.0 [c]
Soviet deliveries	0	0	0.7	1.6	1.5	1.5	1.5	1.5
Apparent consumption [e]	23.8	33.5	32.8	34.8	36.4	36.8	37.5 [c]	36.5 [c]

[a] Including associated gas.
[b] Official plans or estimates based on available information.
[c] Estimated.
[d] Including some coal gas.
[e] Consumption reflects 0.2 billion cubic meters of gas Romania sends annually to Hungary.

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- Warsaw recently signed an agreement with Moscow to provide help on a new pipeline within the Soviet Union in exchange for a total of 2 bcm of gas. Warsaw also has announced its intention to import as much as 12 bcm annually by 1990—double the current level—but has no firm commitments from Moscow beyond the recently signed contract. [redacted]

The other three countries have yet to announce any plans for increased purchases of Soviet gas over the coming decade:

- East German plans show Soviet gas deliveries continuing at their current level of 6.5 bcm annually through at least 1985. Gas imports could rise after 1985 as compensation for current pipeline help and as transit fees for stepped-up gas deliveries to West Berlin. East German contacts told US Embassy officers that, at least for now, East Germany must supply labor for Soviet pipeline construction just to maintain current gas supplies.

- Romania has no plans to increase its modest purchases of Soviet gas although a Romanian economic officer in Moscow recently informed US Embassy officers that Romania would buy more Soviet gas if the price was favorable. Current domestic production of around 35 bcm annually dwarfs imports from the USSR of just 1.5 bcm; reserves probably are sufficient to continue this production pace to the end of the decade.

- Hungarian plans initially had indicated a slight increase in gas imports, but more recent reporting suggests that gas purchases may actually decline. [redacted] Budapest is seeking to reduce its energy dependence on Moscow, and this policy seems to be borne out by other reporting. Budapest recently announced its intention to purchase just 3.5 bcm of gas from the Soviet Union this year compared to 3.8 bcm purchased annually during the last three years. Furthermore, the Hungarians reportedly had planned to sell any gas to the West that they might receive as compensation for additional gas transiting Hungary to Austria or Italy. [redacted] 25X1

Impact on Eastern Europe

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The increase in Soviet gas shipments to Eastern Europe currently planned for the remainder of the decade will prove helpful but will not have a great impact. By 1990, Soviet gas supplies probably will amount to just 8 percent of the region's total primary energy consumption, up only marginally from its current share of 6 percent. Even a doubling of Soviet gas deliveries by 1990 would increase the share to just 11 percent. Any growth in imports of gas and electricity from the Soviet Union will offset reduced hard currency purchases of energy or even further cuts in Soviet oil shipments. Total energy consumption is likely to grow by only 1 percent a year during the period and will be satisfied largely by increased domestic production of coal and nuclear power. [redacted] 25X1

As to the individual countries planning to receive more gas, Bulgaria is likely to benefit the most. A doubling of gas imports would raise the share of gas to about 20 percent of primary energy consumption by 1990, compared to 11 percent in 1982. Increased deliveries of gas to Poland will also be important since Warsaw needs the additional gas to help offset declining domestic production. Nevertheless, the share of Soviet gas in primary energy consumption is unlikely to increase much beyond the current 5- to 6-percent level. Current production of 5.5 bcm is down 30 percent since 1978 and could drop to only 1.5 bcm by the end of the decade. [redacted] For Czechoslovakia, Soviet gas will remain at around 11 percent of primary energy consumption, even if the country receives a 4-bcm increase. [redacted] 25X1 25X1 25X1 25X1 25X1 25X1

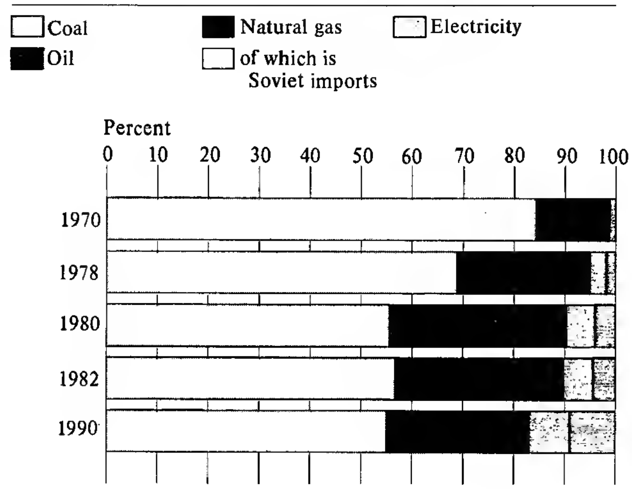
Eastern Europe's apparent reluctance to boost gas imports is mainly due to the slower-than-expected growth of gas consumption. For example, Bulgar-

ia's annual imports of gas still remain well short of planned levels because of delays in the construction of internal pipelines and a shortage of factories designed to burn gas. Moreover, Prague has repeatedly asked Moscow for more oil in lieu of gas because of slack domestic demand and inadequate storage facilities. A Czechoslovak source informed the US Embassy that Andropov may have agreed to supply some additional oil this year instead of gas. 25X1

The region is not likely to be able to afford the amount of construction needed to use significant amounts of additional Soviet gas in the near term. Investment in the region as a whole already has dropped 15 percent over the past two years and will decline again this year. Most investment is directed toward completing existing projects rather than undertaking new ventures. Thus, while the East Europeans recognize that energy is a priority sector, they are focusing investments on projects related to domestic energy production—particularly coal mines and nuclear power plants—and not on new gas pipelines or plant retooling for the use of gas.

Substituting gas for oil would be an enormous and difficult task. For the region as a whole, approximately 60 percent of refined oil products consumed are in the form of gasoline, diesel fuel, and other specialized oil products for which natural gas cannot be easily substituted. The remaining 40 percent consists largely of heavy fuel oils used for heat and power generation for which some substitution is possible. About 5 percent of Eastern Europe's electricity is produced in thermal power plants burning liquid fuels and the regimes would like to reduce even this small share. But substitution may be limited even in this area because these plants burn the very heavy residual fuels that are left at the end of the refining process. These fuels have few other domestic uses and are not usually exportable. Eastern Europe also lacks the catalytic cracking units that are needed to convert the heavy oils into lighter fuels. Many of these cracking units are purchased in the West, and the current hard currency crunch precludes their purchase in significant numbers.

Eastern Europe: Primary Energy Consumption by Type of of Fuel



Source: CIA estimates.

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Outlook

Eastern Europe's demand for Soviet natural gas is unlikely to pick up sharply before the end of the decade. By then, slowing domestic production of natural gas in some countries may spur those regimes to buy more Soviet gas. Moreover, some revival in economic growth at that time may make more feasible the conversion needed to absorb gas. 25X1

Meanwhile, the Soviets are likely to press the region to accept more gas, and increased pressure by Moscow may push Eastern Europe to quicken the pace of investments in the gas area. Nonetheless, the regimes will continue to balk at any attempts by Moscow to replace current oil deliveries with shipments of natural gas, thus frustrating Soviet goals of saving more oil to sell in hard currency markets. 25X1

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